No. 86-776

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

U S WEST, INC.,
Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF RESPONDENT MCI COMMUNICATIONS CORPORATION IN OPPOSITION

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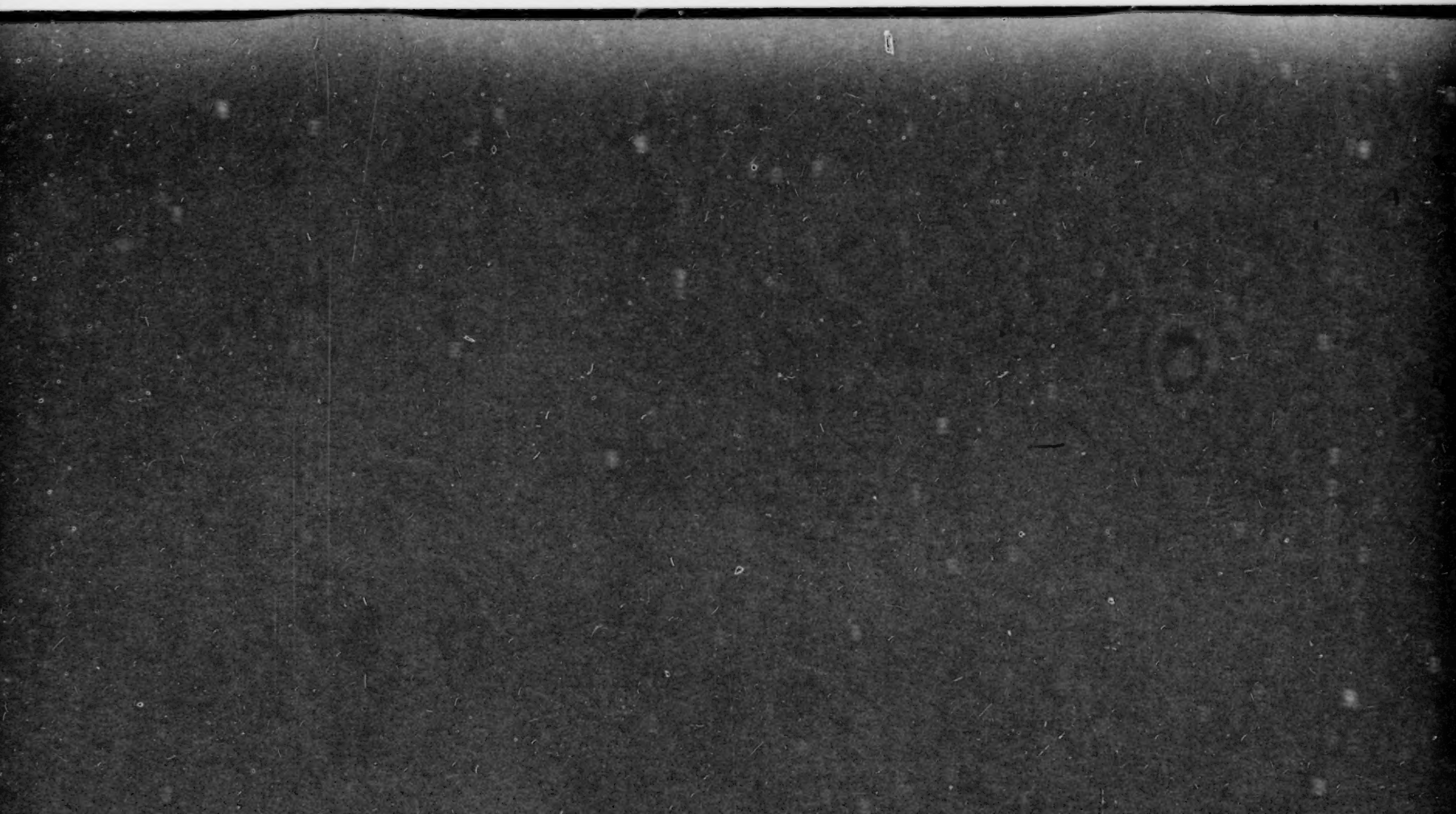

QUESTIONS PRESENTED

1. Whether a divested company that accepted the economic benefits resulting from the divestiture decree is estopped from challenging structural protections against anticompetitive conduct that are an integral part of that court-approved remedy?

2. Whether a parent corporation may represent and bind its wholly-owned subsidiaries to injunctive provisions in a divestiture decree without violating traditional fiduciary principles or the Due Process Clause?

RULE 28.1 STATEMENT

MCI Communications Corporation has no parent corporation, no subsidiaries other than wholly owned subsidiaries, and no affiliates.

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BRIEF OF RESPONDENT MCI COMMUNICATIONS CORPORATION IN OPPOSITION

This case involves the enforceability of injunctive provisions contained in the consent decree that ended the antitrust suit brought by the United States against the American Telephone and Telegraph Company ("AT&T"). The injunction prohibits the divested local Bell telephone companies from participating in business activities where control of the local telephone network would give them unfair competitive advantages.

A participant in the proceedings below,[1] MCI has a strong interest in preserving the integrity of the divesti-

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[1] The district court granted MCI leave to intervene in the appeal below. *United States v. Western Electric Co.*, slip op. (D.D.C. March 20, 1986).

ture decree and its injunctive restrictions. MCI is the second-largest interstate long-distance carrier and the victim of years of the Bell System's monopoly abuse which the consent decree was intended to end. *See, e.g., MCI Communications Corp. v. AT&T*, 708 F.2d 1081, 1139-60 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983); *United States v. AT&T*, 524 F. Supp. 1336, 1352-57 (D.D.C. 1981).

STATEMENT OF THE CASE

Until implementation of the consent decree in the government's antitrust case against AT&T, AT&T controlled the provision of telephone services and equipment in the United States. AT&T achieved this dominance through the Bell System, a vertically integrated enterprise that included AT&T's Long Lines Division, the dominant long-distance company, and the Bell Operating Companies (or "BOCs"), wholly owned subsidiaries that provided monopoly local telephone service in virtually every major American city.

In 1974, the United States filed a lawsuit, known as the *AT&T* case, to require AT&T to divest the local Bell companies. In 1982, the Justice Department concisely summarized the theory of that suit:

> as a rate base/rate of return regulated monoplist, AT&T has had both the incentive and the ability, through cross-subsidization and discriminatory actions, to leverage the power it enjoys in its regulated monopoly markets to foreclose or impede competition in related, potentially competitive markets. The linchpin of AT&T's monopoly power . . . was its ownership and control, through the BOCs, of regulated local exchange monopolies . . . .

Response of the United States to Public Comments on Proposed Modification of Final Judgment, *United States v. Western Electric Co.*, 47 Fed. Reg. 23320, 23335 (1982) [hereafter "Response"].

The *AT&T* case came to trial in 1981. In January 1982, after the district court had heard "well over ninety percent of the parties' evidence both quantitatively and qualitatively," (*United States v. AT&T*, 552 F. Supp. 131, 152 (D.D.C. 1982), *aff'd mem. sub nom. Maryland v. United States*, 460 U.S. 1001 (1983)), the Government and the Bell System announced a proposed settlement subject to judicial approval.[2]

The Line of Business Restrictions

The "central remedial mechanism of the decree" was divestiture and, as its "necessary complement," the injunction prohibiting the local Bell companies from anticompetitively expanding beyond their local telephone monopolies into other lines of business.[3] As the Justice Department told the district court, Bell System anticompetitive abuses had not "thus far proven amenable to successful regulatory solution," so "permitting BOC entry into competitive markets would undermine the rationale [of] divestiture." Response, 47 Fed. Reg. at 23336; *see United States v. Western Electric Co.*, 592 F. Supp. 846, 855 n.20 (D.D.C. 1984), *appeal dismissed*, 777 F.2d 23 (D.C. Cir. 1985). The Government ex-

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[2] The proposed settlement was presented as an agreed "modification" of the 1956 decree settling an earlier antitrust case brought by the Government against the Bell System, *United States v. Western Electric Co.*, Civil Action No. 17-49 (D.N.J., filed Jan. 14, 1949). *See* 552 F. Supp. at 140-41 and 144 & n.51. This is the origin of the term "Modification of Final Judgment" or "MFJ." Later decisions of the district court are therefore captioned *United States v. Western Electric Co.*

[3] Response, 47 Fed. Reg. at 23336, 23323. Section II(D) of the judgment prohibits the local Bell companies from providing interexchange telecommunications services or information services, manufacturing telecommunications equipment, or providing any other product or service (other than exchange communications, marketing of customer premises equipment, and directory advertising) that is not a natural monopoly service actually regulated by tariff. Pet. App. 4a-5a.

plained (Response, 47 Fed. Reg. at 23335) why divestiture without the injunctive restrictions would not provide effective relief:

> Absent the modification's restrictions on BOC lines of business, the BOCs would have the very same incentives and ability to foreclose or impede competition in related markets. Thus, given the BOCs' continuing status as regulated monopolies, the modification's line-of-business restrictions are intended to ensure, consistent with the obligations of this Court, "that there remain no practices likely to result in monopolization in the future."

The district court extensively reviewed the proposed settlement under the Tunney Act, 15 U.S.C. § 16(b)-(h). Over 600 corporations (including MCI), associations, individuals, and federal and state governments and agencies filed over 8,000 pages of commentary on the proposed settlement. *United States v. Western Electric Co.*, slip op. at 1 (D.D.C. May 25, 1982). At the conclusion of the comment period, the district court requested additional briefing and oral argument on specific topics, including whether the injunction prohibiting other business activities was in the public interest.

On August 24, 1982, after reviewing a variety of comments both supporting and opposing the injunctive restrictions, the district court concluded that the restrictions were necessary to prevent the reoccurrence of anticompetitive conduct. 552 F. Supp. at 186-91 (citing *Ford Motor Co. v. United States*, 405 U.S. 562, 577-78 (1972)). The court did, however, modify the proposed restrictions to include a provision (Section VIII(C), *reprinted in* 552 F. Supp. at 231) for waiving the restrictions if and when a local Bell company could demonstrate it no longer had the ability to impede competition in a particular line of business.

Representational Issues

The district court also requested briefing on whether the local Bell companies could or should "have a direct voice in the present proceedings." *United States v. Western Electric Co.*, slip op. at 14 (D.D.C. May 25, 1982). In response, AT&T acknowledged its duty to protect its shareholders' interests in all Bell System assets: "AT&T and the current [local Bell companies] are all segments of a single enterprise owned by a body of shareholders whose interests in Bell System assets AT&T is duty-bound to protect." AT&T Brief in Response to the Court's Memorandum of May 25, 1982, at 108 (filed June 14, 1982). The Justice Department agreed that the local Bell companies did not require separate representation because AT&T acted as their voice in the proceedings. Brief of the United States in Response to the Court's Memorandum of May 25, 1982, at 89 (filed June 14, 1982). Other commenters argued that separate representation was necessary. *United States v. AT&T*, 552 F. Supp. at 220.

The district court ultimately rejected (*id.* at 221) the suggestions for representation on the grounds that AT&T had an enforceable responsibility and a tangible economic interest in protecting all its shareholders. The court also recognized (*id.*) that the local Bell companies had only limited ability to add to the factual and legal arguments made by others, and the court could identify no procedural mechanism that would permit the still-integrated entities to make a contribution to the Tunney Act process.[4]

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[4] *Id.* at 221-22. After judicial approval of the decree imposed a legal obligation to divest, the district court heard testimony on the proposed plan for reorganization of the Bell System from three designated chief executive officers of the holding companies of the to-be-divested local Bell companies, *United States v. Western Electric Co.*, 569 F. Supp. 1057, 1062 & n.4 (D.D.C.), *aff'd mem. sub nom. California v. United States*, 464 U.S. 1013 (1983), and

U S West Accepts the Economic Benefits of The Consent Decree

On January 1, 1984, AT&T divested its holdings in the local Bell companies and transferred their shares to seven newly created regional Bell holding companies (or "RHCs"). Petitioner U S West, one of the regional Bell companies, thereby acquired three local Bell companies. The assets that U S West obtained divestiture were then worth over fifteen billion dollars (*1984 U S West Annual Report*), and have now increased in value to more than seventeen billion dollars (*1985 U S West Annual Report*). In addition, the consent decree assigned (552 F. Supp. at 191-94) directory services to U S West and permitted U S West to market telephones, PBXs, and other types of advanced consumer telecommunications equipment. In 1985, U S West earned over seven billion in revenues (*1985 U S West Annual Report*). U S West has achieved sizable and consistent growth in revenue and profits despite overall losses in the numerous lines of business that it has entered pursuant to court-approved waivers. *See* National Regulatory Research Institute, *Unregulated Enterprises of the Bell Regional Holding Companies*, at 94 (March 1986) ("none of U S West's new subsidiaries are profitable").

U S West acknowledges (Pet. 11-12) that it made no claim until mid-1984 that it and its wholly owned local Bell companies were free to ignore the injunctive provisions of the consent decree. No other regional or local Bell company has made this argument.[5] U S West has

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those holding companies submitted briefs and motions on a range of topics.

[5] At least two regional Bell companies, BellSouth and NYNEX, specifically reject this argument. BellSouth Motion For Leave to Appear As Amicus Curiae, at 1, *United States v. Western Electric Co.* (filed April 1, 1986, D.C. Cir.) ("BellSouth and its subsidiaries are bound by the terms of the AT&T consent decree"); NYNEX Motion For Leave to Appear As Amicus Curiae, at 1, *United States*

acted inconsistently with its present position by seeking substantial additional opportunities through the waiver process in the decree. The district court has granted U S West's requests to enter such lines of business as cellular radio in the Gulf of Mexico, financial services, and provision of vehicle and equipment fleet services.[6]

The Proceedings Below

U S West appealed the district court's denial of certain motions seeking to "clarify" certain aspects of the judgment.[7] The court of appeals rejected (Pet. App. 8a-11a) U.S. West's arguments that it was not bound by the injunctive provisions of the decree. U S West's claim that it was not independently represented failed "because it ignores the facts that AT&T was a party to the antitrust proceeding and both the RHCs and the BOCs were wholly owned subsidiaries of AT&T at the time the consent decree was entered" (Pet. App. 8a-9a). That court found it "self-evident" (Pet. App. 9a) that a parent may bind its wholly owned subsidiaries without affording them independent legal representation. The court held "both specious and irrelevant" (Pet. App. 9a) U S West's contention that AT&T breached a fiduciary duty owed to the local Bell companies by consenting to the line-of-business restrictions.

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v. Western Electric Co. (filed April 1, 1986, D.C. Cir.) ("NYNEX and its subsidiaries are subject to the terms of the AT&T consent decree").

[6] *United States v. Western Electric Co.*, 604 F. Supp. 256, 263-64 (D.D.C. 1984); *United States v. Western Electric Co.*, slip op. (D.D.C. Aug. 22, 1985); *United States v. Western Electric Co.*, slip op. (D.D.C. Feb. 28, 1986).

[7] Pet. App. 5a-6a & n.3. As the court of appeals acknowledged, U S West raised before the district court, in at best an oblique fashion, the argument presented to this Court in its petition. Pet. App. 8a n.4.

ARGUMENT

Petitioner Is Estopped From Challenging The Obligations Of A Decree The Benefits Of Which It Has Already Accepted

With overtones of an action seeking a remedy for wrongful life of unexpected offspring, petitioner challenges an integral part of the compromise settlement that gave it independent existence. The challenge comes only after U S West's voluntary acceptance of billions of dollars in assets, as well as its frequent invocation of decree-based rights to obtain waivers from decree restrictions.

Unsurprisingly, petitioner (Pet. 24) claims that it is "not arguing here that the divestiture itself was unlawful or should be reversed," but instead seeks only to void the "injunctive provisions" which are petitioner's sole decree obligations. Yet the removal of these restrictions would undermine the essential "rationale of divestiture" and leave the local Bell companies "the very same incentives and ability to foreclose or impede competition in related markets." *See* Response, 47 Fed. Reg. at 23335 (*see* pages 3-4 above). Indeed, the judge administering the consent decree reiterated (Pet. App. 25a) that without these structural limits "the result of the breakup would have been to exchange one nationwide monopoly with the incentive and ability to exploit monopoly power and injure competition for several smaller monopolies with the identical incentives and abilities." Elimination would, as a practical matter, nullify divestiture and make the sometimes wrenching changes that divestiture entailed a pointless exercise.

The consent decree brought to an end decades of turmoil within the telecommunications industry and imposed structural solutions to persistent antitrust abuses which could not otherwise be successfully addressed. *See* Response, 47 Fed. Reg. at 13336-37 (*see* page 3 above). One of the major beneficiaries of that resolution was petitioner,

which gained valuable assets and the other benefits of a monopoly franchise. Having amassed assets of almost 20 billion dollars and taken in billions more in revenues from monopoly franchises bestowed on it by the decree, petitioner now seeks to avoid its concomitant obligations. This is preeminently a circumstance in which public policy requires that a party not "be allowed to attack an officially approved condition of . . . [a court order] while retaining at the same time all of its benefits." *FPC* v. *Colorado Interstate Gas Co.*, 348 U.S. 492, 502 (1955).

AT&T's Wholly-Owned Subsidiaries Were Properly Bound by the Injunctive Provisions of the Divestiture Decree

As U S West acknowledges (Pet. 24), AT&T as sole shareholder and owner of the local Bell companies had "lawful privity" which entitled it to dispose of its subsidiaries' assets. The court below correctly held (Pet. App. 9a) that "[t]his intimate corporate affiliation" also allowed the parent to bind its subsidiary to injunctive restrictions upon the use of its assets. *Southmark Properties v. Charles House Corp.*, 742 F.2d 862, 870 (5th Cir. 1984). This traditional rule that complete corporate ownership produces privity also enables a plaintiff to sue a corporate parent and obtain injunctive relief against all of its wholly-owned subsidiaries. *See Computer Searching Service Corp. v. Ryan*, 439 F.2d 6, 9 (2d Cir.), *cert. denied*, 404 U.S. 871 (1971). Abrogation of this rule would have several serious consequences: litigation of divestiture cases would become substantially more complicated; negotiation of consent decrees involving divestiture would be seriously hampered; and the enforceability of outstanding decrees would be called into question.

As a typical application of the settled principle that "under the antitrust laws, corporations and their wholly-owned subsidiaries function as a single enterprise" (Pet. App. 11a, citing *Copperweld Corp. v. Independence Tube*

Corp., 467 U.S. 752 (1984)), the decision below creates no conflict requiring resolution by this Court. Petitioner relies (Pet. 19-21) on *Pepper v. Litton*, 308 U.S. 295 (1939), for the wholly irrelevant fiduciary principle that contracts between dominant stockholders and a corporation must be at arms-length so that profit will not be secured at the expense of minority stockholders. Divestiture gave the stockholders of AT&T stock in U S West and the other regional Bell companies as well, and no suggestion has been made that any portion of those stockholders who owned both AT&T and the local Bell companies before and after divestiture were disadvantaged by the Modified Final Judgment. Indeed, by removing restrictions in another decree binding the Bell System since 1956 (Pet. 3), the consent decree expanded the lines of business that entities owned by Bell shareholders could enter.

Nor is due process violated by unitary pre-divestiture representation merely because of anticipated post-divestiture conflicts. Neither of the two cases cited by petitioner (Pet. 24-25) purports to establish a due process right of separate representation whenever the interests of parents and subsidiaries might be expected to diverge after entry of a divestiture decree.[8] If as petitioner as-

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[8] In *Cascade Natural Gas Corp. v. El Paso Natural Gas Co.*, 386 U.S. 129, 136 (1967), this Court suggested that a subsidiary of El Paso be permitted to renegotiate unfavorable contracts negotiated by the parent, but only because the Supreme Court had earlier ordered that the subsidiary be "restored to a position where it could compete with El Paso in the California market" and because the Court had serious concerns about non-compliance with its mandate. No similar consideration exists here. In *FTC v. Exxon Corp.*, 636 F.2d 1336, 1342 (D.C. Cir. 1980), the court of appeals affirmed a district court order that a division of a wholly-owned but newly-acquired subsidiary should have counsel independent from its parent, but only because complete separation of the parent from the subsidiary pursuant to a hold-separate order in an FTC challenge to the acquisition was necessary "to ensure that any divestiture later ordered would not be a hollow remedy." Here, the integration of parent and subsidiary had lasted a century.

serts (Pet. 23) "the interests of AT&T and the BOCs diverged," that "divergence" did not occur at least until the divestiture decree was approved.[9] AT&T was therefore entitled to represent its shareholders throughout the Tunney Act proceedings and to bind its wholly-owned subsidiaries to beneficial agreements.

CONCLUSION

The petition for a writ of certiorari should be denied.

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[9] Even though the district court had only limited authority to reject or modify the terms of the proposed decree (*United States v. AT&T*, 552 F. Supp. at 151), not even U S West suggests that local Bell companies were entitled to separate representation before the proposed decree was submitted to the district court.